

# In the United States Bankruptcy Court

## for the Northern District of Iowa

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TERRANCE ROBERT McGRATH and SARA  
ELIZABETH McGRATH

Debtors.

Bankruptcy No. X91-01410F

Chapter 7

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JAMES H. COSSITT, Trustee

Plaintiff

Adversary No. X91-0224F

vs.

TERRANCE R. McGRATH and SARA E. W. McGRATH

Defendants.

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### MEMORANDUM OF DECISION AND ORDER RE: OBJECTION TO DISCHARGE; OBJECTION TO EXEMPTION

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The trustee objects to the debtors' discharge and to the claim of exemption in a homestead. The consolidated trial of these core proceedings came before the court on February 26, 1993.

#### Findings

Terrance and Sara McGrath, husband and wife, filed their joint petition under chapter 7 on July 29, 1991. With their petition, they filed the required Statement of Financial Affairs and Schedules. (Exhibit 1.) Debtors signed unsworn declarations, under penalty of perjury, that the Statement and Schedules were true and correct. (Exhibit 1.) Schedule A-2 listed Brenton Bank, Des Moines, as a creditor holding a \$189,000.00 claim secured by a mortgage against a home. Schedule A-3 listed unsecured creditors, but it omitted any reference to the dates the debts were incurred and any reference to whether the debts were joint or individual obligations. In the Statement of Affairs, the debtors answered "no" to question 12(a): "Have you made any gifts, other than ordinary and usual presents to family members and charitable donations, during the year immediately preceding the filing of the original petition herein?" They also answered "no" to question 12(b) which asked "[h]ave you made any other transfer, absolute or for the purpose of security, or any other disposition, of real or personal property during the year immediately preceding the filing of the original petition herein?" (Exhibit 1.) Debtors' Schedule B-1 disclosed ownership of a homestead valued at \$245,000.00; the equity in the home, estimated at \$56,000.00, was claimed exempt.

James H. Cossitt was appointed trustee of the estate. He examined debtors at the meeting of creditors on September 16, 1991. Debtors gave their examination testimony under oath. (Exhibit 5, page 2.) Their testimony included the following:

Q. [Did you list] all of your creditors?"

A. (Terrance) Yes.

A. (Sara) Yes.

(Exhibit 5, page 3, lines 15-17.)

Q. Other than birthday and Christmas gifts, have either of you transferred anything of value to any relatives

during the 12 months before the case was filed?

A. (Terrance) No sir.

A. (Sara) No.

(Exhibit 5, page 3, lines 21-25.)

Q. Let me ask you a little bit about that house. How long have you folks lived in Clive?

A. (Terrance) Since September of, one year ago 1990.

Q. September of 1990?

A. (Terrance) Right.

Q. Okay. What did you pay for that house when you bought it?

A. (Terrance) \$227,000.00.

Q. And apparently you mortgaged about \$190,000.00 on it?

A. (Terrance) Right.

Q. Okay. How much did you put into it when you acquired it?

A. (Terrance) You mean as far as cash?

Q. Cash.

A. \$33,000.00 to \$34,000.00.

Q. 33 or 34?

A. (Terrance) Right. With closing costs and everything.

Q. And that was in the form of the cash you had to come up with at closing?

A. (Terrance) Right.

Q. Okay. What was the source of the 33 or 34 thousand dollars that you put into acquiring this house?

A. (Terrance) Well back then I had some savings and then we had some money coming from Ford at that time too that I had anticipated.

(Exhibit 5, page 6, line 22 through page 7, line 18.)

Q. Okay. What happened to the house that you owned here in Fort Dodge? It is not on the bankruptcy papers so that tells me that you no longer have an ownership interest in it.

A. (Terrance) We sold it and used the equity from that home on this home. I moved from Fort Dodge in August of 1990. I was done at the Ford dealership here in town in August 21, 1990, and I went to work at that time for Charles Gabus Ford in Des Moines.

Q. Okay. So you testified now that the money that you plowed into this new house was from savings, it was

some money from Ford and it was some equity out of your old house.

A. (Terrance) Right, and I cashed in my IRA too.

Q. Okay. If I'm understanding your testimony correctly you have identified four different sources of funds that you used to acquire your interests in the new residence.

A. (Terrance) Mhum.

Q. Okay. And if I also understand your testimony correctly that from these four different sources you were able to raise roughly 33 to 34 thousand dollars to acquire the new residence.

A. (Terrance) Yes sir.

Q. Could you go though (sic) each one of those sources and tell me roughly how much money was acquired from each source to meet that total amount.

A. (Terrance) We had what 13 thousand on the home?

\* \* \*

(Exhibit 5, page 8, lines 2-26.)

A. (Sara) We had 9 thousand in the IRA.

A. (Terrance) We had 9 thousand in the IRA.

Q. So roughly 9 grand in the IRA?

A. (Terrance) That was at Norwest Bank. And we had like 13 thousand in equity in the home.

Q. 13 thousand equity out of the old house. That was after the realtor's costs and . . .

A. (Terrance) Mhum.

Q. So you netted about 13 grand when you sold the old house?

A. (Terrance) Mhum.

Q. Okay. Then . . .

A. (Terrance) then we had about 20 thousand in savings and what have you there.

Q. Well let's just tighten that up a little bit if we might. You said savings and money from Ford and what have you.

A. (Sara) 10 thousand from Ford.

A. (Terrance) 10 thousand from Ford.

Q. Okay.

A. (Terrance) And then I had about another 9 thousand in savings.

Q. Okay. The amounts that you just told me about, these different sources of funds that you used for this house, did you get money from any of these sources that exceeded the amounts that you just told me about.

## A. (Terrance) No.

(Exhibit 5, page 9, line 3 through page 10, line 1.)

The trustee objected to the debtors' claim of homestead exemption. The trustee claimed that most of the scheduled unsecured debts were contracted prior to the acquisition of the property as a homestead so that the property was not exempt to the extent of the pre-acquisition liabilities. (Objection, docket no. 12.) Trustee later obtained an order requiring debtors to amend their schedules to indicate the dates unsecured debts were incurred. (Exhibit 2.) Debtors filed their amendment to Schedules A-2 and A-3 on February 19, 1992. (Docket no. 32.) Amended Schedule A-2 listed Bruce McGrath, Terrance's brother, as a secured creditor holding a second mortgage against the couple's homestead. Debtors indicated that the debt was incurred in October, 1990. The amendment was unclear as to the amount of the debt and the value of the security.

Amended Schedule A-3 listed 23 non-duplicative creditors. Seven of the claims were listed as having been incurred prior to July, 1986. Two others were listed as having been incurred in July, 1986.

<b>Creditor</b>	<b>Date Incurred</b>	<b>Amount</b>
Tom Kelly	July, 1986	\$40,000.00
Norwest Bank	July, 1986	15,000.00
Bank IV, Wichita	November, 1984	Unknown
First Bankcard	March, 1981	Unknown
J. C. Penney	November, 1979	Unknown
KBC	November, 1984	Unknown
Merchants Nat.	October, 1985	8,369.56
MICO	August, 1980	24,800.00
Younkers	June, 1984	1,080.62

Other debts were incurred during the period from July, 1986, to August 1, 1990.

<b>Creditor</b>	<b>Date Incurred</b>	<b>Amount</b>
Younkers	June, 1984	1,080.62
CitiBank Mastercard	January, 1990	\$1,782.25
CitiBank Preferred	June, 1989	7,211.37
Duncan, Jones	April, May 1990	1,104.86
Federated Insurance	July, 1990	237.00
MBNA America	January, 1990	885.00
VISA	June, 1989	Unknown

Two debts were listed as having been incurred in August, 1990: Ford Motor Credit Company, amount "unknown," and L & D Drycleaners in the amount of \$50.02. Five debts were listed as having been incurred in October, 1990, or after that date:

<b>Creditor</b>	<b>Date Incurred</b>	<b>Amount</b>
Brenton Nat. Bank	October, 1990	Unknown
Brenton Mortgages, Inc.	October, 1990	Unknown
Lenhart Plumbing	October, 1990	Unknown

Walters Homes	September, 1990	\$1,110.23
Schnutt & Co.	February, 1991	765.00

No date was listed for the debt to Clarice McGrath. The obligation arose from the decree dissolving the marriage. It entered in September, 1988.

There was nothing on the amended schedules to indicate whether any of the unsecured debts were joint or individual obligations.

At the meeting of creditors, the trustee asked Terrance McGrath to turn over various documents relating to McGrath's former interest in a Ford automobile dealership in Fort Dodge. He also asked McGrath for documents relating to the termination or transfer of that interest. McGrath did not immediately turn over the documents. The trustee filed his Complaint objecting to discharge on November 12, 1991, stating as one ground of objection the debtors' failure to surrender the documents. Trustee deposed Terrance McGrath on December 23, 1991. Although McGrath had possession of a significant number of the requested documents at the time of the Meeting of Creditors, they were not surrendered to the trustee until December, 1991; some were surrendered just prior to the deposition, some a short time after the deposition.

Terrance McGrath is 52 years old. In January, 1986, he married Clarice McGrath; they were living in Houston, Texas. In early, 1986, the couple began their effort to acquire a Ford automobile dealership. Because Clarice was African-American, the couple qualified for a program fostering ownership of dealerships by members of minorities; the program provided advantageous financing. The couple was successful in acquiring a dealership in Fort Dodge. They moved there in 1986. The couple bought a home in July, 1986. Although the dealership was successful, the couple's marriage suffered because of racial prejudice they encountered in Fort Dodge. They were divorced on September 6, 1988. (Exhibit 7.) By Stipulation, Terrance was to receive the dealership. Clarice received the homestead free of Terrance's interests but subject to liens against the property. If the home were sold within five years of the Decree, the equity in the home was to be divided. (Exhibit 7.) Clarice sold the house to Terrance on or about October 21, 1988. (Exhibit 9.) A quit claim deed was recorded on October 31, 1988. (Exhibit 10.)

McGrath ran into difficulty in operating the dealership. A minority dealers organization complained to Ford that McGrath was enjoying the benefits of minority ownership without being a member of a minority group. As the details are not relevant to the court's decision, suffice it to say that Clarice regained control of the dealership, and McGrath relinquished his interest. He believed that he was the object of "reverse discrimination" and sought legal advice on possible remedies against Ford Motors.

Sometime shortly after divorcing Clarice, McGrath married a woman named Maureen. By sometime in 1990, the couple began having marital problems, and they divorced. In the end, the relationship was acrimonious. In September, 1990, McGrath left Fort Dodge for a job at a dealership in Des Moines. Sometime during this period, at least by early September, 1990, and perhaps as early as August, McGrath married Sara. (Exhibit 6, page 18.) Terrance and Sara sold the Fort Dodge home in early September, 1990, and closed on the sale in early November. The Fort Dodge home was sold for \$105,000.00, although \$5,000.00 of the price was alleged to be for personalty. A dispute arose between Terrance and Clarice as to the division of the sale proceeds. The dispute was presented to the Iowa District Court for Webster County. Presiding Judge Louie F. Beisser issued a decision in March, 1991, determining the division and awarding Terrance \$12,866.39. Judge Beisser found that the proceeds of sale were, at the time of his decision, being held by Terrance's attorney in the attorney's trust account.

Sara and Terrance bought a home in Clive, a Des Moines suburb, in September, 1990. The purchase price was \$227,000.00; the house was appraised at the end of August for \$244,000.00. (Exhibit 12.) To make the purchase, the couple obtained a loan at Brenton National Bank of Des Moines (BANK). (Exhibit 13.) The Bank made two loans, one a first mortgage loan for \$181,600.00, the second loan for a shorter period in the amount of \$17,900.00. The short-term loan was secured by a second mortgage. (Exhibit 13.) The couple was approximately \$27,500.00 short of the purchase price plus any closing costs.

Terrance's brother Bruce was a car dealer in Cedar Rapids, Iowa. He agreed to help Terrance with the purchase, and on

September 30, 1990, he wrote Terrance a check for \$25,000.00 on an account of Bruce McGrath Pontiac, Inc. (Exhibit 14.)

Closing on the purchase took place on about October 8 or 9, 1990. On October 8, the couple executed a mortgage for Bank which was recorded the following day. (Exhibit 11.) The couple signed a promissory note to Bruce McGrath, dated October 14, 1990, in the amount of \$25,000.00. (Exhibit 14.) Also on October 14, 1990, the couple executed a mortgage in favor of Bruce McGrath. It was recorded on October 29, 1990. It recited in paragraph 27, the intent of the parties that it be a purchase money mortgage.

The couple moved into their new home in early December, 1990. Although Terrance and Sara took title to the home as tenants-in-common, on December 29, 1990, they executed a Quit Claim Deed transferring the property to Sara. The deed was recorded February 7, 1991. (Exhibit 11.) The consideration represented on the face of the deed was less than \$500.00; it was described as a "family transaction."

The transaction was not disclosed in the Statement of Affairs or during the meeting of creditors. The motive for nondisclosure was Terrance's concern that his former wives might "attach" the house, and he wanted to keep it and his new wife out of any further litigation with Clarice or Maureen. McGrath testified that his former wives were extremely vindictive causing him an "awful lot of problems." (Trial testimony of Terrance McGrath; exhibit 6, deposition page 57, lines

17-24.)

After the filing of the trustee's objection to discharge, and during a deposition conducted as part of the proceeding, Terrance first admitted that one source of funds for the purchase of the Clive home was the loan from Bruce McGrath. (Exhibit 6, page 24, lines 17-25.) Although in the initial stages of the deposition the source of the purchase money was still obfuscated, it eventually became clear that the Bank and the brother were the only sources and that no money had come from an IRA, the Ford settlement or the sale of the Fort Dodge home.

In his deposition, McGrath said he did not know why he omitted the debt to his brother from his schedules. (Exhibit 6, page 28, lines 20-25 to page 29, lines 1-4.) At trial, he testified that he failed to list his brother because he learned the bankruptcy would be filed in Cedar Rapids where his brother had his car dealership and that he hoped to spare his brother embarrassment from Terrance's problems.

## Discussion

Trustee objects to the debtors' homestead claim on the ground that the home is not exempt from pre-acquisition debts of the McGraths. Trustee objects to debtors' discharge on five grounds: first, that debtors failed to timely turn over documents to which the trustee had a right of possession (11 U.S.C. § 727(a)(4)(D)); second, that the same documents were fraudulently concealed from the trustee (11 U.S.C. § 727(a)(3)); third, that at the meeting of creditors, the debtors intentionally testified falsely as to the source of the funds used to purchase the Clive home (11 U.S.C. § 727(a)(4)(A)); fourth, that debtors filed schedules which they knew to be false because they omitted Bruce McGrath as a creditor (11 U.S.C. § 727(a)(4)(A)); and fifth, that debtors knowingly failed to disclose in their statement that they had disposed of the Fort Dodge homestead and that Terrance had transferred his interest in the Clive homestead to Sara (11 U.S.C. § 727(a)(4)(A)).

In the Joint Pretrial Statement filed October 14, 1992, debtors admitted that at their meeting of creditors, they "made a false oath by not listing all creditors or transfers related to their estate. . . ." They also admitted that at the meeting of creditors, they "falsely testified where the funds came from to put the down payment on their new house in Clive. . . ." (Joint Pretrial Statement, page 5.)

At trial, Terrance McGrath admitted his failure to disclose Bruce McGrath as a creditor and his failure to disclose the transfer of his interest in the Clive home to Sara. Debtors' counsel, in acknowledging the false oaths, argues that debtors' motives were not bad and that creditors were not injured. He contends that denial of discharge is too severe a remedy under these circumstances and that a more equitable remedy is a money judgment against the debtors to compensate the

trustee for the time spent in discovering the true state of affairs.

Because debtors intentionally told untruths in their schedules and in the testimony at the meeting of creditors, they are not entitled to discharges.

Section 727(a)(4)(A) of the Bankruptcy Code (Title 11) provides that "[t]he court shall grant the debtor a discharge, unless-- . . . the debtor knowingly and fraudulently, in or in connection with the case-- made a false oath. . . ."

There is no question in this case that Terrance and Sara McGrath deliberately executed a false schedule of secured creditors, omitting the known claim of Bruce McGrath; without question, they knowingly omitted from their Statement of Financial Affairs the transfer of Terrance's interest in the homestead to Sara. Upon being questioned about these same areas at the meeting of creditors, they intentionally and knowingly affirmed that false information.

The omissions were material because the information bore a relationship to the debtors' personal transactions, their financial dealings and their disposition of assets. Palatine National Bank v. Olson (In re Olson), 916 F.2d 481, 484 (8th Cir. 1990). Despite the fact that the transactions related to a property claimed exempt, the omissions bore substantial relevance to issues which a trustee would normally investigate. The mortgage to the brother was executed two weeks after the loan; the mortgage was recorded nearly four weeks after the loan. A trustee could reasonably want to investigate whether a mortgage was originally intended, and thus whether the mortgage was a preferential transfer. If avoidable, it could be preserved for the benefit of the estate. Such legitimate inquiries were frustrated by the concealment of the information. The failure to disclose the transfer of Terrance's interest in the homestead also inhibited the trustee's ability to investigate the nature and extent of a major asset which had been claimed as exempt.

Debtors contend that there was no bad motive in failing to list Bruce McGrath. If it were true that in concealing Bruce McGrath's claim Terrance and Sara sought only to spare him personal embarrassment, such a motive does not detract from the debtors' swearing of a false oath. The court does not consider their motive relevant. With reference to the Bankruptcy Act, the Circuit Court has held that the "false oath" necessary to justify denial of discharge involves "an intentional untruth in a matter material to an issue which is itself material." Aronofsky v. Bostian, 133 F.2d 290, 292 (8th Cir. 1943). The Court went on to say that "[i]t is not necessary that one who swears falsely in a matter material to an issue before a court shall understand and appreciate at the time all of the consequences, advantageous or detrimental, that may flow from the act of false swearing. It suffices that he knows what is true and so knowing wilfully and intentionally swears to what is false." Id. at 292.

"Deliberate omissions by the debtor may . . . result in denial of discharge." Chalik v. Moorefield (In re Chalik), 748 F.2d 616, 618 (11th Cir. 1984). The trustee need not show detriment to the creditors, nor does it matter whether or not the debtor intended to injure his creditors. Id.

A debtor may not weigh his obligation to tell the truth against his private justification for lying, choose the latter, and then only be saddled with the costs incurred by creditors in discovering the lie. Debtor's obligation is to tell the truth. "A discharge is a privilege and not a right and therefore the strict requirements of accuracy is a small quid pro quo. The successful functioning of the Bankruptcy Code hinges upon the bankrupt's veracity and his willingness to make a full disclosure." Hillis v. Martin (In re Martin), 124 B.R. 542, 547-48 (Bankr. N.D. Ind. 1991). Full disclosure is a prerequisite to obtaining a discharge. American State Bank v. Montgomery (In re Montgomery), 86 B.R. 948, 956 (Bankr. N.D. Ind. 1988) citing In re Hargis, 50 B.R. 698, 700 (Bankr. W.D. Ky. 1985).

Despite the motive expressed by Terrance, the false oaths were still fraudulent. The debtors knew their statements were false, and they intended that parties be deceived--they did not want others to know about Bruce McGrath as a creditor. Nor did they want creditors to know about the transfer of the real estate interest from Terrance to Sara. As to the latter concealment, the motive was not so benign--the couple was attempting to transfer the property to Sara's sole ownership to prevent Terrance's former wives from involving it in further litigation. Clarice was a creditor at the time. Failure to disclose the transfer can be seen as an additional step in that effort.

Debtors' counsel asks that because debtors intended no harm to their creditors, that a lesser remedy than denial of discharge be imposed. Even if debtors were not malevolently motivated, Congress has not given the court such discretion. It has prescribed denial as the penalty for giving a false oath; that penalty must be applied here.

Because McGraths intentionally disregarded their obligations to tell the truth, their discharges will be denied. The court does not reach the remaining issues relating to the retention and concealment of records.

### **Objection to Homestead**

The McGraths claim the homestead as exempt. Debtors purchased the house in early October, 1990. They moved in in December. Trustee argues that the bulk of the unsecured debt pre-dates acquisition of the property as a homestead. Much of it does. The court can specifically attribute certain pre-acquisition debts to Terrance. Terrance's debts to Tom Kelly and to Norwest Bank aggregate \$55,000.00. Clearly, if this case involved only Terrance, the trustee's objection would be sustained. However, the court is unable, by preponderance of the evidence, to attribute any pre-acquisition debts to Sara. As it is trustee's burden, pursuant to Fed.R.Bankr.P. 4003(c), to show the exemption was not properly claimed, the court cannot, based upon the evidence before it, sustain the homestead objection as to Sara's interest. Inasmuch as an Iowa homestead exemption may not be "split", the objection to Terrance's claim, if any, cannot be sustained. Merchants Mut. Bonding Co. v. Underberg, 291 N.W.2d 19, 21 (Iowa 1980). The court has examined the homestead issue as if both parties held title. The result is no different if only Sara holds title as a result of the pre-petition transfer.

### **ORDER**

IT IS ORDERED that the trustee's objection to discharge is sustained.

IT IS ORDERED that the discharges of Terrance R. McGrath and Sara Elizabeth McGrath are denied. Judgment shall enter accordingly.

IT IS ORDERED that the trustee's objection to the claim of exemption in homestead is overruled. Judgment shall enter accordingly.

SO ORDERED ON THIS 8th DAY OF SEPTEMBER, 1993.

William L. Edmonds  
Chief Bankruptcy Judge

I certify that on \_\_\_\_\_ I mailed a copy of this order and a judgment by U. S. mail to: Dan McGrevey, James Cossitt, and U. S. Trustee.